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May 2, 2005

David M. Eichenlaub
Division of Economics and Finance
State Corporation Commission
1300 East Main Street
Richmond, VA 23219

Re: Comments Concerning the Status of Competition -- Compliance by the State Corporation Commission with § 56-596.B of the Code of Virginia

Dear Mr. Eichenlaub:

Thank you for your letter of March 17, 2005, requesting comments regarding the status of competition in Virginia pursuant to Virginia Code § 56-596.B.[1] We respond on behalf of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates (collectively, "the Committees"), which consist of large industrial customers of Dominion Virginia Power ("DVP") and Appalachian Power Company ("APCo"), respectively.

In response to prior years' requests of the Commission Staff for comments on the status of competition, the Committees have observed that retail competition for generation services has failed to develop in Virginia. With the exception of a miniscule number of customers purchasing at prices above "capped rates" from a competitive service provider that had stopped offering the service to new customers, there was no retail competition at all.

In terms of the existence of retail competition, little, if anything, has changed; electric competition still has failed to develop in Virginia. Restructuring in Virginia has fallen below expectations in other respects as well, as demonstrated by the attached Report Card on Electric Utility Restructuring, which evaluates progress on key issues related to competition and restructuring. (See Attachment I.) It reveals low or failing grades on the degree of retail competition, prospects for future customer savings from competition, customer rates during the transition to competition, the assessment of stranded costs and benefits (*i.e.*, whether power

[1] Section 56-596.B of Virginia's Electric Utility Restructuring Act ("Restructuring Act"), Va. Code § 56-596.B, requires the Commission to recommend actions to be taken by the General Assembly, the Commission, electric utilities, suppliers, generators, distributors and regional transmission entities that the Commission considers to be in the public interest, including actions regarding the supply and demand balance for generation services, new and existing generation capacity, transmission constraints, market power, suppliers licensed and operating in the Commonwealth, and the shared or joint use of generation sites.

plants are worth more or less than book value), and entry of independent power producers. The only "A" grade is utility earnings. Functioning of a regional transmission entity earned a "C" grade after DVP and APCo finally joined the PJM Interconnection LLC, four years after the original statutory deadline. While "capped rates" may provide incentives for reduced distribution and transmission reliability, that category receives no grade because it is still being assessed.

Virginia electricity customers in communities in the western part of the Commonwealth are feeling the impact of going to market-based rates. With the expiration of wholesale power contracts that supplied their local, municipally owned utilities for years, retail customers in such communities face significant rate increases.

The Federal Energy Regulatory Commission now has ruled in the case involving DVP's request to defer $280 million in estimated RTO-related costs until after 2010, when its "capped rates" are scheduled to expire. Attachment II discusses the case. DVP sought the deferral in order to allow such costs to be passed through to its customers. DVP represented to the General Assembly, however, that the 2004 amendments to the Restructuring Act, which extend its "capped rates" through 2010 and freeze its fuel factor until July 1, 2007, would benefit its customers by imposing on DVP the risks of new costs.

In formulating the Commission's findings regarding the status of competition, and in developing recommendations to the General Assembly, the Committees urge the Commission to consider these comments. Electric restructuring has not worked so far in Virginia, and current developments do not bode well for its future success.

The Committees appreciate the opportunity to comment, and they look forward to continuing to assist the Commission in its response to the mandate contained in Virginia Code § 56-596.B.

Sincerely,

Louis R. Monacell

Edward L. Petrini

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ATTACHMENT I

REPORT CARD
VIRGINIA ELECTRIC RESTRUCTURING

ISSUE	GRADE	COMMENT
Degree of retail competition	F	Retail competition has produced no customer savings. A significant portion of Virginia's retail customers has had the legal right to choose since January 1, 2002. With the exception of a few "green" power sales at prices higher than the utility's capped rates, no supplier has offered to serve retail customers.
Prospects for future savings from retail choice	D	Present market prices and trends suggest that Appalachian Power Comopany's ("APCo's") customers have no prospect for future savings. Dominion Virginia Power's ("DVP's") customers' prospects for such savings are dim in view of the fact that market prices now exceed capped generation rates.
Customers rates during the transition to competition	D	In October 2003, the State Corporation Commission ("SCC") Staff issued its most recent report on DVP's earnings and, in that report, the Staff indicated that DVP's rates are excessive by 10% and would be reduced by approximately $400 million per year if its rates were to be reset based on cost of service. Rates of DVP's customers have soared since the Act passed in 1999 because the Act has permitted rate "adjustments" to reflect increased fuel costs, and such costs have increased. A 2004 amendment to the Act freezes DVP's 2004 fuel factor through June 2007, and customers are paying a lower fuel factor than otherwise would have been the case. Fuel factor savings, however, fall well below the excess found by Staff in DVP's non-fuel rates. APCo customers' rates appear to be only moderately excessive. In April 2005, the SCC Staff issued its most recent report on APCo's earnings. The report indicated a "revenue surplus" of $9.6 million, or about 1%. Further, 2004 amendments to the Act encourage unfair single issue rate increases for APCo without the ability to review the total cost of service to determine whether there are any cost reduction offsets.

May 2, 2005

Utility earnings	A	DVP's annual report to the SCC for 2003 states that DVP earned a jurisdictional return of 13.26% on common equity. The SCC Staff has not completed its review of DVP's report; however, the 13.26% rate of return exceeds the 9.10% to 10.10% rate of return found reasonable in its review of DVP's prior annual report. DVP has not filed its 2004 annual financial report with the SCC. APCo's Virginia electric business appears to have produced modest over-earnings during 2003, as indicated in the recent SCC Staff report discussed above. The Staff has not reviewed APCo's 2004 earnings.
Assessment of stranded costs and stranded benefits (whether power plants are worth more or less than book value)	F	The Virginia Electric Utility Restructuring Act ("Act") requires an assessment of whether utilities have over- or under-collected "stranded costs" (*i.e.*, costs rendered unrecoverable as a result of restructuring and competition). Despite the likelihood that no stranded costs exist, no such determination has been made. In fact, the existence of significant stranded benefits is more likely. According to the SCC Staff, since DVP's rates were capped by the Act effective July 1, 1999, DVP has earned more than $800 million toward stranded cost recovery, yet no stranded costs may even exist.
Functioning of Regional Transmission Entity (RTE)	C	The Act initially required utilities to join an RTE by January 1, 2001. Neither DVP nor APCo met the statutory deadline. In 2003, two years after the deadline, the General Assembly eliminated the original deadline and enacted a *new* deadline that requires utilities to join an RTE by January 1, 2005, subject to approval by the SCC. Both utilities have now joined the PJM Interconnection, LLC ("PJM").
Entry of independent power producers	D	Generation owned or controlled by DVP and APCo continues to dominate Virginia's generation market. Independent power producers have built little new generation since passage of the Act. In fact, DVP has added to its generation fleet more MWs than the independents. As a result, market power has not been eliminated and possibly has been enhanced.

Reliability of distribution and transmission system	No grade yet	Capped rates could motivate Virginia utilities to decrease expenditures on reliability in order to increase profits and thereby reduce reliability. The SCC, in reviewing utilities' responses to Hurricane Isabel, stated that it appeared that DVP had decreased the number of linemen it employs but that "the Staff has not observed a deterioration in day-to-day operations based on standard measures of performance." Nevertheless, the Staff determined that it was appropriate to conduct an "in-depth audit" of DVP's resources beginning in the fourth quarter of 2004 as a result of "(i) anecdotal feedback from customers and anonymous employees relative to a decline in resources, (ii) the natural incentive to reduce resources within a rate cap environment, and (iii) the belief that any deleterious effects of a reduction in resources might not materialize until years later …" The SCC staff's audit has not been completed.

ATTACHMENT II

Dominion Virginia Power's
Deferral of $280 Million of
RTO Costs Until 2011

Dominion Virginia Power ("DVP") urged the General Assembly to amend the Virginia Electric Utility Restructuring Act by enacting SB 651, effective July 1, 2004. It argued that the bill would benefit its customers by freezing their rates at the current level and by imposing upon DVP all of the risks of new costs.

On May 11, 2004, however, DVP and the PJM Interconnection LLC ("PJM") filed with the Federal Energy Regulatory Commission ("FERC") a joint application to establish PJM South and transfer control of DVP's transmission assets to PJM. In the application, DVP asked FERC to permit it to defer approximately $280 million in costs, plus carrying charges, that DVP estimates it will incur from seeking to join and joining a regional transmission organization ("RTO"). DVP argued in the application that it should be entitled to defer such costs and collect them after the expiration of the "capped rate" period in Virginia because "a state imposed rate cap will prevent Dominion from being able to recover any of the RTO-related costs."[1] The "capped rate" period is scheduled to end January 1, 2011. DVP further stated that it should be entitled to defer and collect such costs from its customers because "Dominion is not eligible for any rate cases or any of the aforementioned rate adjustments. It is subject to the rate cap which became effective January 1, 2001, and which now will extend through December 31, 2010."[2]

In FERC's order of October 5, 2004, approving DVP's entry into PJM, FERC stated that it could not determine whether such costs are, in fact, unrecoverable in DVP's current rates or whether they ultimately would be found in a FERC rate case to be recoverable in future rates.[3] Nevertheless, FERC stated that DVP itself must assess all available evidence bearing on the likelihood of rate recovery of such costs in periods other than the period in which they would otherwise be charged to expense under the general accounting requirements for such costs. If DVP determines that it is probable that these costs will be recovered in rates in future periods, then it should record a regulatory asset for such costs.[4]

On March 4, 2005, the FERC denied rehearing of its October 5 order regarding the RTO-related costs.[5] FERC stated that it had made no finding in its October 5 order concerning the "ultimate justness and reasonableness" of the RTO-related costs and that such a finding could be made only in a DVP rate case at FERC. FERC characterized its October 5 order regarding such costs as providing "guidance" on "the proper accounting and recordation of a regulatory asset"

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[1] *PJM Interconnection, L.L.C.*, FERC Dkt. No. ER04-829-000, Joint Application at 20.
[2] Id., Joint Application at 21, fn. 45.
[3] Id. , Order Establishing PJM-South Subject to Conditions, dated October 5, 2004 (slip op. at 21).
[4] Id.
[5] Id., Order Denying Rehearing, dated March 4, 2005 (slip op. at 13).

and as "procedural in nature without prejudice to any party seeking to challenge the subsequent recoverability of these costs in a future rate case."[6]

FERC states that DVP itself, not FERC, must determine the recoverability of such costs in rates in periods other than the period in which they are incurred, and FERC states that DVP must support its determination with "relevant, reliable evidence demonstrating that it indeed meets the criteria for recognition of a regulatory asset ... at the time it makes the initial determination, each accounting period thereafter, and when it makes its [rate] filing." [7]

Despite the FERC's assurances in its order on rehearing that it intends only to address the accounting, not the ratemaking, treatment of the RTO-related costs, and that parties may challenge the "regulatory asset" treatment of such costs in a later rate case, FERC's order provides little comfort to DVP's customers. While not a model of clarity, FERC's order on rehearing still permits DVP, not FERC, to determine whether DVP may book the RTO-related costs periodically as a "regulatory asset." By permitting DVP to make such periodic determinations on its own, until its rates are re-set by FERC, the order thus appears to permit DVP to record on its books what may turn out to be an enormous "regulatory asset." When FERC decides the ratemaking treatment of that "regulatory asset" in a rate case, FERC may find it difficult to refuse to recognize such RTO-related cost deferrals in setting rates due to the impact such refusal on DVP's annual earnings.

In any case, DVP should not be permitted to argue to the Virginia General Assembly that it is willing to bear the risk of all new costs during the "capped rate" period and, at the same time, argue to the FERC that, because of the "capped rates," it should be permitted to defer $280 million of RTO costs so that all such costs will be borne by its customers after the expiration of "capped rates."

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[6] Id.
[7] Id.